

## IAS 2 Inventories

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What are inventories?

IAS 2

= assets that are:

- ✓ Held for *sale in the ordinary* course of business
- ✓ In the *process of production* for such a sale
- ✓ In the form of *materials or supplies to be consumed* in the production process or in the rendering of services

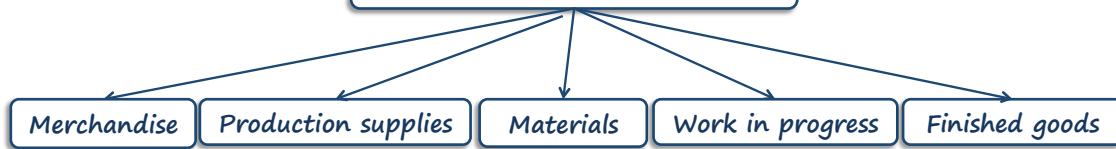
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If used for admin purposes => PPE (IAS 16)

If held to resale (car dealers) => Inventories (IAS 2)

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### What are inventories?



**xxx** IAS 2 does NOT apply to:

- x** Work in progress under long-term contracts (IFRS 15)
- x** Financial instruments (IFRS 9)
- x** Biological assets (IAS 41)

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### Measurement of inventories

**Measurement rule:** Inventories should be measured at

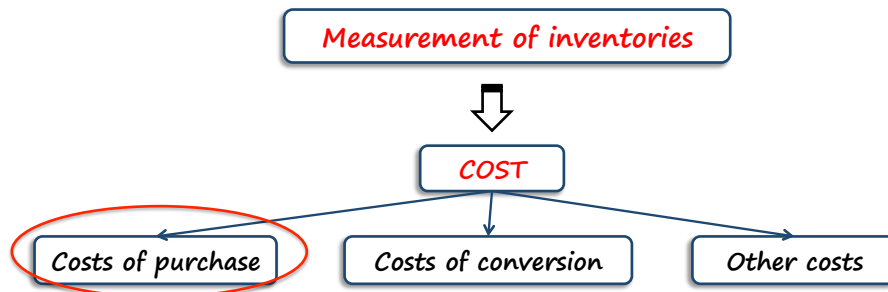
**LOWER OF:**



**xxx** Measurement exceptions:

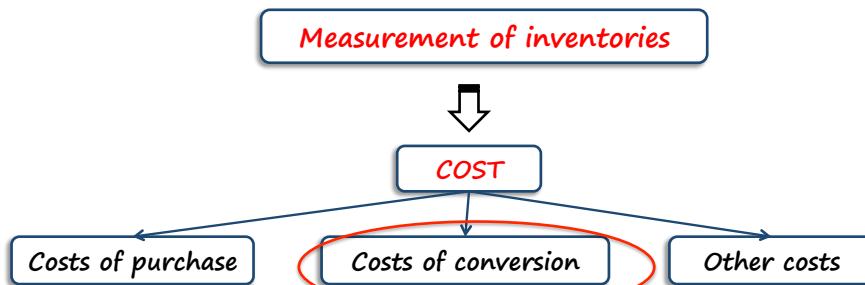
- x** Producers of agricultural, forest products, minerals and mineral products
- x** Commodity dealers and brokers

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- ✓ Purchase price
- ✓ Import duties, other non-refundable taxes
- ✓ Costs directly attributable to the acquisition of finished goods, services and materials (handling, transport)
- ✓ Less trade discounts, rebates and similar.

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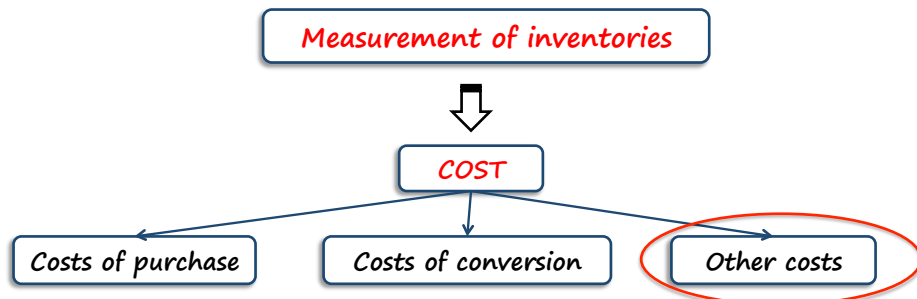
- ✓ Costs directly related to the units of production (direct materials, direct labour)
- ✓ Production overheads allocated on a systematic basis
  - Fixed (cost of factory management)
  - Variable (indirect materials)

! Allocate **fixed production overheads** based on **normal capacity of the production facilities**

- ✓ Under normal circumstances, deduct time for planned maintenance
- ✓ If low production/idle => No higher allocation => Unallocated overheads in P/L
- ✓ If abnormally high production => Reduce allocation

! Allocate **variable production overheads** based on **actual use**

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✓ If incurred in bringing the inventories to their present location and condition

**Do NOT include:**

- ✗ Abnormal waste (material, labour, other)
- ✗ Storage costs (but include those necessary in the production process)
- ✗ Administrative overheads
- ✗ Selling costs

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**Cost: Measurement techniques**

✓ For convenience to approximate cost of inventories

**Standard costs**

- ✓ Normal production values (raw materials, labour)
- ✓ Reviewed and revised regularly

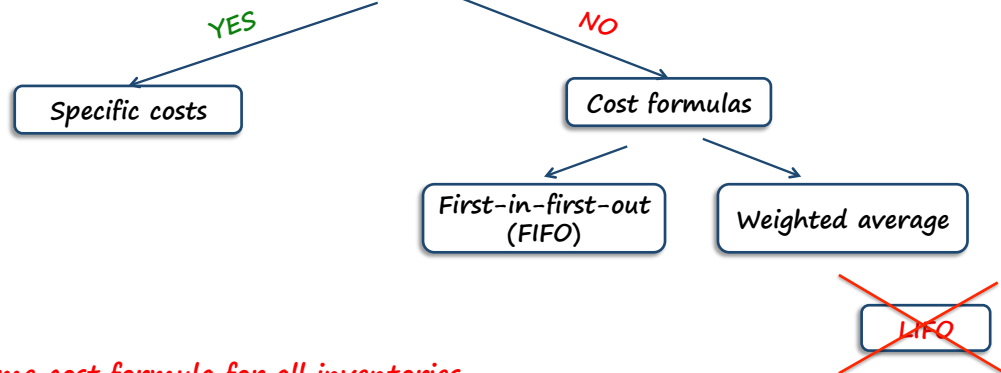
**Retail method**

- ✓ When large turnover of inventories with similar profit margins
- ✓  $\text{Cost of inventory} = \text{Selling price} - \text{Profit margin}$

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## Cost formulas

Are the inventories *not interchangeable*?  
Are the goods or services *produced and segregated for specific project*?



!!!Use the same cost formula for all inventories with similar nature and use!!!

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## Measurement of inventories



### NET REALISABLE VALUE

$$\text{Estimated selling price} - \text{Estimated costs of completion} - \text{Estimated selling costs}$$

✓ If  $\text{NRV} < \text{costs}$  => Write-down

When can NRV fall below cost?

- ✓ Increase in cost / fall in selling price
- ✓ Physical deterioration
- ✓ Obsolescence
- ✓ Management's decision to sell at loss
- ✓ Errors in production/purchasing

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## Measurement of inventories



### NET REALISABLE VALUE

$$= \text{Estimated selling price} - \text{Estimated costs of completion} - \text{Estimated selling costs}$$

✓ If NRV < costs => Write down

#### How to assess NRV?

- ✓ Item by item, but similar items can be grouped
- ✓ Re-assess at the end of each reporting period
- ✓ At the time of estimating selling price
- ✓ Reversal of write-down is possible
- ✓ Why inventory is held (contract? general?)

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## How to account for inventories

	DEBIT	CREDIT
When inventories are sold:	P/L Cost of sales	Inventories
Write-down of inventories:	P/L Write-down of inventories / COS	Inventories (allowance)
Reversal of write-down:	Inventories (allowance)	P/L Reversal of write-down / COS

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